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SUBJECT: TURKEY'S AMBITIOUS AGENDA FOR TRADE WITH IRAQ

Classified By: Economic Counselor Dale Eppler for reasons 1.4 (b) and (d).

1.(C) Summary. During a recent visit by the Iraq Interagency Team, Foreign Trade Undersecretariat (FTU) Deputy Undersecretary Sevket Ilgac provided a comprehensive summary of current Turkish-Iraqi trade relations and laid out Turkey's vision for the future of the relationship. Trade has boomed since the reopening of the border in 2003, reaching USD 5.2 billion in 2008 (up 50% from 2007). Even with the global crisis trade has continued to grow and the expectation is that it will exceed USD 7 billion by the end of 2009. To maintain this momentum, Turkey hopes to implement a number of projects/agreements over the near and medium term, including: 1) a Qualified Industrial Zone along the border, 2) signing a Free Trade Agreement (this requires EU consent), 3) signing a double taxation agreement, 4) harmonization of customs infrastructure, 5) improved transportation, communication and electrical links, 6) establishment of a Turkish Trade Center in Baghdad and regular monthly "Turkish Products Fairs" in Baghdad, 7) increasing capacity on the Kirkuk-Yumurtalik pipeline, and 8) development of the Qasap oil field and construction of an electric plant on site. Ilgac acknowledged that this agenda may be ambitious, but was optimistic that it was achievable, especially given recent improvements in the technical capacity of FTU's Iraqi interlocutors. End summary.

¶2. (SBU) The Iraq Interagency Team recently met with Foreign Trade Undersecretariat (FTU) Deputy Undersecretary Sevket Ilgac to discuss Turkish-Iraqi trade relations. Ilgac provided a broad overview of the trade relationship and laid out an ambitious agenda for increasing trade ties.

After Years of Drought, Trade Blossoms in the Desert

¶3. (U) Prior to the first Gulf War, Iraq had been one of Turkey's largest trading partners, with annual trade of USD 5.5 billion. With the imposition of UN sanctions, this trade dropped to negligible levels. Ilgac estimated that Turkey suffered USD 120 billion in trade losses due to the UN sanctions between 1990 and 2003. Trade resumed on May 22, 2003, and after years of fitful growth finally began to take off over the last few years as the security situation improved. In 2008, Turkish-Iraqi trade grew by 50 percent and reached USD 5.2 billion, of which USD 3.9 billion were Turkish exports. Turkish exports consist mostly of food, electrical machinery, construction materials, furniture, textiles, vehicles and parts. Iraqi exports to Turkey are mostly petrochemicals.

¶4. (U) Despite the impact of the global economic crisis, Turkish-Iraqi trade has continued to grow, with USD 1.3 billion in trade in the first three months of 2009. During that period, Turkey's overall exports fell by 32 percent but exports to Iraq grew by 76 percent, making Iraq Turkey's second largest export market after Germany. FTU expects that bilateral trade will surpass USD 7 billion in 2009 and anticipates that it will more than double to USD 15 billion in 2010 as the effects of the crisis begin to wane.

¶5. (U) Two recent high-level visits have given added impetus to the relationship. PM Erdogan's July 2008 visit to Baghdad led to the creation of a High-Level Strategic Cooperation Council, which will hold its first meeting this month in Istanbul. President Gul's March 2009 visit resulted in a Comprehensive Economic Partnership Agreement, which laid out a path toward an eventual free trade agreement. The aim, he repeatedly stated, is to create a fully integrated single economic zone.

Turkey's Vision for Trade with Iraq

¶6. (C) Ilgac laid out what he described as the "short to medium term" goals of the GOT with regard to trade with Iraq, describing a number of projects for moving the trade relationship forward. These include:

-- Qualified Industrial Zone(QIZ): Turkey hopes to agree soon on the establishment of a QIZ along the Iraqi border,

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where goods produced in the zone would have duty free access to the other market. Ilgac noted that the Turkish side of the border would probably focus on heavy industry and refining, while the Iraqi side would be geared toward basic manufacturing. He also expressed hope that the EU, United States and Japan would consider giving duty-free treatment to goods from the zone, or at least from the Iraqi side. He noted that the GOT was planning to sign an MOU with the GOI at the Gaziantep Trade Fair on May 23-24.

-- Free Trade Agreement (FTA): As noted in para. 5, the Turkey-Iraq Comprehensive Economic Partnership Agreement envisions the eventual creation of an FTA. Because of Turkey's EU Customs Union membership and its EU candidacy, Turkey requires a "derogation" from the EU to negotiate such an agreement. Ilgac admitted that Turkey has not yet requested such derogation, but observed that Turkey recently obtained EU consent to free trade agreements with Syria and Georgia, and that he did not expect it would be a problem for Iraq. Given the economic situation in Iraq, Ilgac noted that Turkey expected the first stage of an FTA would involve a Turkish concessionary zero tariff rate for at least ten years.

-- Double Taxation Agreement

-- Harmonization of customs infrastructure: By pushing Iraq to harmonize its customs rules with Turkey (and therefore by extension with the EU), FTU hopes that it can create a "single window" customs infrastructure that will greatly ease the flow of goods across the border.

-- Improved transportation links: Almost all Turkish-Iraqi trade is conducted at the single land border crossing at Habur Gate or by the rail lines connecting Turkey and Iraq via Syria. The Habur Gate currently handles 261,000 trucks per year, but has the capacity to handle nearly a million. One of the factors inhibiting use of the border is the lack of a reliable transportation network to reach it. To counter this, Turkey is already rehabilitating/extending the highway from the port of Mersin to Gaziantep and plans to extend it through to Baghdad and eventually to Basra. To provide a direct rail link, they are looking at building a rail line along the same route, but have not yet determined the most

appropriate crossing point into Iraq. In the meantime, they are working to modernize the Nusaybin rail border gate with Syria to allow for expanded trade destined for Iraq.

-- Improved communication links: The GOT is encouraging Turkish telecom firms to invest in broadband deployment in Iraq and is looking to tie the Iraqi communication network together with the Turkish one.

-- High-capacity electrical connection: Turkey is hoping to build a high-capacity electrical connection tying together the two countries' electrical grids. Turkey is already a net exporter of electricity to Iraq, and increased capacity should enable more Turkish power to feed into the Iraqi system.

-- Increased awareness of Turkish products: To raise the profile of Turkish goods, FTU is planning to establish a Turkish Trade Center in Baghdad, which would serve not only to showcase Turkish goods but also offer space for Turkish firms operating in Iraq to conduct deals, hold exhibitions, etc. Beginning in July 2009, FTU will also hold monthly fairs in Baghdad highlighting Turkish products.

-- Improved oil pipeline capacity: Although the Kirkuk-Yumurtalik pipeline is currently operating at only 25 percent capacity, Ilgac predicted that when an agreement on oil exports is reached there will be a tremendous demand for pipeline capacity out of northern Iraq. To meet this, FTU is looking at ways to both fully utilize and increase the capacity of the existing oil pipeline and also exploring the feasibility of an accompanying natural gas pipeline along the same route.

-- Development of the Qasab oil field: Ilgac noted that Turkey hopes to jointly develop the Qasab oil field near Mosul together with the GOI, and that Turkey would commit to build an electric plant on site to make effective use of the field's output.

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17. (C) Ilgac acknowledged that this was a wide-ranging agenda, and noted that one of the key impediments to date has been the lack of stability and technical capacity in their Iraqi interlocutors, dryly observing that for years each meeting has begun with the Turkish side teaching the Iraqis the basics of what had already been agreed. He was guardedly optimistic about the future, however, saying that the capability of the Iraqi side had improved markedly in recent months. He also noted that FTU and the Turkish Cooperation and Development Agency (TIKA) had provided or offered to provide training to Iraqi officials on various trade-related issues.

Comment

18. (C) Turkey and Iraq are natural trading partners, both because of geographical proximity and because the mix of goods and services they provide are largely complementary (Turkey supplies manufactured goods, Iraq supplies oil and gas). FTU's hope to double the existing trade to USD 15 billion in the short-term is therefore probably achievable - especially if an Iraqi hydrocarbons law is passed - although it may take more than just a year and a half to reach that goal. The GOT has recognized the importance of Iraq as a market and as a supplier of energy and appears to be taking a long view of its relationship, as evidenced by its willingness to extend concessionary tariffs for more than a decade and to embark on rail-building projects that will take years.

19. (C) Comment continued: Expanding economic ties could easily be a win-win for both countries, but the breadth of the agenda indicates that it will be a long road without USG

and international help. Expanded Turkish trade and investment in Iraq serves USG strategic interests in both Turkey and Iraq. Turkish commercial interests will keep Turkey actively engaged in Iraq. It will help rebuild Iraq's economy and tie it more firmly to Turkey's dynamic, market-oriented economy, while Iraq will provide badly-needed export and energy source diversification. End comment.

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